

NOTICE

TO: INTERESTED PARTIES
In Docket No. E-00000A-02-0051

FROM: Ernest G. Johnson
Director, Utilities Division

SUBJECT: Draft Proposal and Request for Comments

DATE: September 13, 2002

Attached is a draft proposal regarding the first solicitation table. Please provide comments to Staff on the proposal. Comments should be e-mailed by September 18, 2002, to rpasula@cc.state.az.us.

If you have any questions, please contact Barbara Keene at (602) 542-0853 or Erinn Andreasen at (602) 542-0748.

2003 SOLICITATION PROCESS

In order to facilitate a manageable transition to a competitive wholesale power market that benefits consumers in Arizona, the Staff believes that a transparent process, one that is equitable and auditable, needs to be established. That process must be well developed, flexible and understood by all participants in the process. Furthermore, the process must result in reliable power being available over the long term at prices that are reasonable. Finally, all bidders prepared to provide power must be afforded the opportunity to compete for sales on equal and unbiased terms. The following pages describe a set of steps and requirements that, if adopted, will establish a process for developing a wholesale market that would satisfy all of these needs.

The process described below is intended to be used by Arizona utilities, as applicable, in the initial solicitation for competitive power to be commenced by March 2003. Subsequent solicitations may be conducted using this process. More likely, changes to the process will be recommended based on lessons learned from the 2003 solicitation and changes in wholesale market conditions.

Initial Steps

A. Resource Plans

Prior to the first solicitation, each utility that will solicit power during 2003 must provide to the Staff and the monitor appointed pursuant to sub-section D a current 10-year load forecast and resource plan. Utility personnel must be made available to discuss the load forecast and resource plan with the Staff and the monitor.

The Resource Plan must describe all power sources including; generation owned by the utility, existing power supply contracts with affiliated and non-affiliated utilities, planned additions and retirements, contract expirations, loads to be met through the use of demand side management and contracts to satisfy the Environmental Portfolio Standard. The Resource Plan should identify RMR plants and hours during which such plants are RMR. Additionally, the Resource Plan should detail the utility's planned outage schedule and any planned unavailability of power from contract suppliers.

Based on the utility's load forecast and the resource plan, the utility will develop a needs assessment. The needs assessment will be designed to identify specific capacity and energy needs and such other services and/or facilities as may be needed over the term of the load forecast.

The load forecast, resource plan and needs assessment will be reviewed with the Staff and, once appointed, the independent monitor.

B. **Cost Forecasts**

Each utility will provide to the Staff its four-year forecast of its power supply costs from existing power sources.

Additionally, each utility shall provide to the Staff a four-year forecast of the cost of wholesale power supplies in Western wholesale markets for delivery in Arizona prepared by an independent source that makes such estimates available in the normal course of its business. Each utility shall also provide to the Staff copies of all other forecasts of the cost of wholesale power supplies in Western wholesale markets for delivery in Arizona in the possession of reviewed by the utility.

The utility shall identify the source of each such forecast, and explain the strengths and weaknesses of each of the forecasts supplied. The forecasts provided will remain confidential and will serve as the basis for certain evaluative and review purposes as are discussed later in this document.

Based on the utility's forecasts of its power supply cost, the submitted forecast of wholesale power supply costs in Arizona, and such other information as it deems appropriate, the Staff shall establish a "price to beat" for each product solicited for each utility. Those prices, if not exceeded, will establish a basis for the Staff to recommend Commission approval of the price components of individual contracts, and to allow for the recovery of costs incurred pursuant to said contracts by each utility from its ratepayers under adjustment clauses

established by the Commission, or base rates approved by the Commission. The “prices to beat” will not be disclosed until final bid selections are announced.

During the reviews described above, the Staff will examine the assumptions relied on by each utility in making the forecasts and assessments presented. The Staff will also review with the utility the adequacy of resources committed to serve expected loads and the reliability of the resources planned to serve that load. The utility shall provide to the Staff a listing of all committed uses of its transmission capacity. The Staff review will include an examination of transmission resource commitments intended to serve non-native load.

Upon completion of this review, the utility will be responsible for preparing and conducting a solicitation that encourages multiple bidders to respond to the solicitation. The specifics of products to be solicited, contract terms and conditions, terms of the confidentiality agreement, and the specific solicitation mechanics to be employed will be at the discretion of the utility. In any event, the process must be designed to promote acquisition of reliable power at reasonable cost over the long term.

C. Deliverability Qualifications

The utility must provide Staff and the monitor with a listing of each committed use of its transmission capacity for the period over which resources are to be solicited.

The utility will perform and submit for review by the Staff and the monitor a network transmission assessment of the maximum resource capacity that can be physically and reliably accommodated at all technologically feasible interconnection and delivery points. Such transmission limitations are to be used as a guide in the evaluation of deliverability of specific combinations of bid resource capacity and energy.

D. Selection and Role of the Independent Monitor

To assist the Staff and to assure all parties to the Solicitation for power supplies that the process employed is conducted in an effective, efficient and equitable manner, an independent monitor will be appointed by the Staff of the Commission to oversee the conduct of the Solicitation. The monitor will be selected by the Staff and will work at the Staff's direction. The utility will employ the monitor selected and will be responsible for all costs associated with such employment.

The monitor will be responsible for:

- monitoring all communications by and among the utility and any bidders or potential bidders;
- evaluating the adequacy, accuracy and completeness of all solicitation materials, and the quality of the evaluations conducted;
- monitoring any negotiations conducted by the utility and any bidder;
- assisting the Staff as required; and,

- preparing and submitting a report to the Commission detailing the monitor's observations and findings relating to the conduct of the solicitation and any recommendations for improvements of the solicitation process employed in the 2003 solicitation.

The monitor shall have full access to all materials used in or relating to the Solicitation. The utility shall make its personnel available for consultation with the monitor as requested. Bids received may be opened only in the presence of the Staff and the monitor, and shall be opened at the Commission. The monitor shall attend, in person or telephonically, any negotiations conducted with bidders.

Subsequent to the final bid selections and prior to announcing the selection of winning bids, the utility shall meet with the Staff and the monitor to review its bid evaluations and to explain the basis for its selections.

Preparation for the 2003 Solicitation

The utility will prepare bid packages that contain a description of the specific products to be acquired, the capacity and energy to be acquired, the bidding method to be employed (e.g. Request for Proposal or Descending Clock Auction), a copy of the contract to be executed, the preferred delivery points, the evaluation criteria to be used, bid fees (if any), credit requirements, due dates and such other information as may be appropriate.

For 2003, the solicitation will be for all load not served by generation owned by the utility as of September 1, 2002, or by power supplied pursuant to

pre-existing contracts with affiliated and non-affiliated suppliers. To the extent that affiliated suppliers provide service pursuant to contracts dated on or after September 1, 2002, such service will be subject to competitive solicitation except to the extent that such contract is to provide RMR service during RMR hours. Any generation capacity owned by a utility that has not been included in the utility's rate base and been accorded rate recovery may be bid by the utility in the 2003 solicitation on the same terms and conditions as all other bidders, including affiliated bidders.

Based on information available at this time, contestable loads for each utility for each year through 2006 are estimated to be:

	2003	2004	2005	2006
APS ¹	1951 MW	2289 MW	2628 MW	2898 MW
TEP				

Each utility shall determine the specific products it will contract for in order to maintain an appropriately structured power supply portfolio. For 2003, utilities may request bids for firm power (e.g. on-peak and off-peak annual or seasonal capacity and energy blocks), and unit commitments, as appropriate. Additionally, to the extent required, solicitations for ancillary services including but not limited to load following or spinning reserves, may be undertaken. It is, however,

¹ Source: From data provided by APS at the August Workshop.

anticipated that bidders will provide all ancillary services required to support their bids.

For solicitations during 2003, each utility may contract for energy and capacity deliveries for differing time periods in order to test the efficiency of this process for acquiring short-term, medium-term and long-term contracts. While it is anticipated that during 2003 each utility will primarily require peaking capacity and energy with contract terms of one to three years, if, in the judgment of the utility, market conditions or economic opportunities dictate contract terms longer than three years, it will be the responsibility of the utility to enter into such contracts as are reasonable. For resource planning purposes each utility must demonstrate that its power supply portfolio contract durations are adequately diversified and that its portfolio's structure mitigates both cost and reliability risks appropriately.

In preparation for the solicitation, each utility shall prepare a list of potential bidders to whom bid materials will be sent. That list should be as expansive as is reasonable. Once assembled, that list is to be provided to the Staff.

Concurrently, the utility will establish the methods it will employ to communicate with all potential bidders. That communications plan must be designed to maintain confidentiality and to provide equal access to information to all. Each utility may devise its own approach for communicating with bidders, but all bidders, including utility affiliates, must be required to communicate with the

utility on equal terms. Additionally, each utility shall establish a web site to further facilitate timely access to data and other information. The approach adopted must be shown to provide no undue advantage to any potential bidder.

As part of the communications protocols established by the utility, each utility shall establish a system for logging all contacts between utility personnel and bidders and potential bidders. That protocol must, at a minimum, require recording the date and time of any conversation, whether telephonic or in person, the substance of that discussion and whether the monitor participated in the contact, maintaining copies of all e-mails exchanged between the utility and bidders or potential bidders, maintaining copies of all correspondence, all such other communications as may occur regarding the solicitation. The utility shall post on the appropriate web site, its responses to all inquiries made relative to the solicitation.

It will be the responsibility of the utility to prepare draft solicitation materials and to discuss these drafts with the Staff and the independent monitor prior to distributing them to potential bidders. These drafts will include but not be limited to: the specific power supply products sought, points of delivery, a model contract and confidentiality agreement, the bid requirements, the solicitation method to be employed, information describing the utility and its forecast load, and the evaluation criteria to be used.

In identifying the products to be contracted for, the utility will specifically define the capacity and energy sought on a time-differentiated basis and the

periods for which services will be purchased. The model contract will contain the terms and conditions proposed by the utility, including the right of the utility to reject all bids and to amend the request for service without notice.

In the Solicitation materials the utility will describe in detail how it will conduct bidding, such as how many rounds of bids will be accepted, Descending Clock Auction procedures, etc. Bids tendered in a Descending Clock Auction are to be firm and must at a minimum remain open until the auction is complete. During bidding, a representative of the Staff may be present and the independent monitor must be present. The utility may also specify how long bids must be open after the auction is completed. If a Request for Proposal is published, a utility may specify that bids must be valid for up to 60 days.

The solicitation materials will also describe the criteria to be used to select winning bids and the weighting, if any, to be placed on each criterion.

The following criteria may be used to evaluate bids:

- Delivered price
- Deliverability
- Reliability
- Creditworthiness
- Exceptions to bid specifications and/or model contract terms and conditions
- Other criteria as appropriate and made publicly available

The bid materials will also describe the Supplier information to be provided and the dates when such information is due. This requirement may include a demonstration of the bidder's experience in providing services and evidence of

the bidder's creditworthiness. Utilities shall require bidders to provide the sources of electricity they intend to use to supply service.

The bid materials will specifically describe the credit support acceptable to the utility both as to form and amount.

Bid materials will also include:

- A draft Confidentiality Agreement
- Identification of any pre-qualification requirements
- Identification of any bid fees

All bidders will be required to consent to use appropriate alternative dispute resolution practices, if a dispute arises, specified by the utility and fully disclosed in the Solicitation materials.

Each bidder must agree to permit the Commission staff to inspect any generating facility the bidder owns or controls from which it proposes to provide capacity or energy to any Arizona utility pursuant to any contract awarded as a result of this solicitation.

Subsequent to the Staff review, copies of the draft solicitation materials will be provided to potential bidders for comment. The utility will schedule a bidders conference open to all interested parties to receive comments and to answer questions regarding the materials prepared.

Based on the comments received, the utility shall make such changes as it deems necessary and publish in final form its solicitation materials.

Conducting the Solicitation

All bids presented shall be sealed. Electronically submitted bids must be secured and may not be opened except in the presence of the monitor. When bids are opened, the Staff and RUCO may attend. However, no party selling or which may sell energy in competitive markets may attend.

Bidders may submit multiple bids to a utility as part of the Solicitation. Bids, pursuant to a Request for Proposal, are to be received within 30 days after publication of the final solicitation materials. If a Descending Clock Auction is to be employed, said auction will be scheduled to occur within 30 days of publication of solicitation materials. During that 30-day period, pre-qualification requirements are to be evaluated. The specific pre-qualification requirements are dependent on the products to be contracted for and will be established by the utility and disclosed in its solicitation materials.

Bids in response to a Request for Proposal are confidential and are to be submitted in sealed envelopes to be opened simultaneously in the presence of the bid evaluators, assigned Commission Staff personnel, and the independent monitor. Bids tendered may not be withdrawn for 60 days or until rejected by the utility.

Bid evaluation will be conducted by a team of personnel including representatives of the utility and the independent monitor. During the evaluations, the Staff may be present. Final bid selections will be at the sole discretion of the utility.

The “price to beat” set by the Staff will not be disclosed until final bid selections are announced. Price caps or auction reserve prices may be established by the utility. Any caps or auction reserve prices established must be disclosed to and discussed with the Staff and the monitor before the solicitation occurs. No caps are to be placed on the maximum or minimum capacity or energy that any bidder may bid for or provide.

The bid package prepared by the utility should specify preferred delivery points and if available, equivalent delivery points and any incremental costs the utility will incur if bidders deliver to those equivalent delivery points. The utility shall disclose to the bidders the existence of the network transmission assessment previously provided to the Staff, and disclose that the assessment will be used in evaluating equivalent delivery points. Bidders may propose delivery to alternative points (i.e. points other than those specified). In such case, the utility shall determine the deliverability of the capacity and energy bid using its best efforts. The solicitation materials will specify the process the utility will use to identify whether any constraints would be created on its system as a result of deliveries to the proposed alternative delivery point, how it will estimate the cost and time required to relieve the constraint, and the costs a bidder will incur to complete the required analysis.

Solicitation Costs

The cost of conducting each solicitation is a business expense to be borne by all bidders in a fair and equitable manner. To that end, bid fees of up to \$10,000 per bidder will be permissible. To the extent that bid fees collected exceed the incremental expenses incurred by the utility to conduct the solicitation, such excess is to be refunded to all non-winning bidders pro rata up to the amount of the bid fee actually paid by the bidder. Any costs incurred by the utility in excess of bid fees collected may be considered for ratemaking purposes.

Any utility requiring the payment of bid fees will be responsible for their collection and, if required, the refund of any amounts collected in excess of the costs incurred in conducting the solicitation.

Bid Evaluation

During the solicitation process, the independent monitor will oversee the solicitation process to ensure compliance with process requirements and to assure that evaluations are conducted in an unbiased fashion. The Staff may observe the solicitation process at its discretion.

Bid evaluations should be conducted in three phases. The first should be to rank order the bids by price using valuation methods that equalize volumetric and or duration differences on a price basis. In the case of a Descending Clock Auction for firm power at fixed prices, only pre-qualified bids will be rank ordered.

In the case of unit commitment Requests for Proposals or for non-conforming offers more comprehensive approaches to valuing the bids may be employed. Such methods should determine an equivalent per MWh net present value of the cost of the bid by using approved annuity-based approaches.

Phase Two should evaluate deliverability using the network transmission assessment previously provided to the Staff. To the extent practicable, network resource status should be assigned to appropriate bids. Network integration service is to be provided pursuant to each utility's OATT. If a bid imposes delivery costs on the utility, the bid price as evaluated should be adjusted to reflect those costs and a new rank order established. If the bidder is prepared to mitigate those costs at its expense, no such adjustment need be made.

During Phase Three all other factors are to be evaluated. These include evaluations of creditworthiness, experience and proposed exceptions to model contract terms and/or conditions.

To the extent necessary, the utility may conduct post bid negotiations with selected bidders to clarify bid terms or to resolve issues relating to exceptions noted in submitted bids. Additionally, the utility may conduct final negotiations with selected bidders to resolve any other issues that may arise. All such meetings are to be attended by the independent monitor to assure that no undue advantage is afforded any bidder. Based on the evaluations conducted, the utility will, after consultation with the independent monitor, and discussion with Staff, select the winning bids.

Terms Required for Staff Recommendation

In subsequent proceedings to recover the cost of power purchased pursuant to contracts entered as a result of the 2003 Solicitation, the Staff will recommend the Commission find the prices contained in such contracts are reasonable if the following conditions are met:

- For contracts with durations of three years or less, the Staff will recommend approving contract prices when such prices in each year of the contract are less than the “price to beat” established by the Staff and permit, at the utility’s sole discretion, extension of the contract for the same number of years at comparable prices and on the same terms.
- For contracts with durations longer than three years but less than eight years, the Staff will recommend that the Commission find the prices contained in any contract reasonable when, in each year of the contract delivery period, prices for power are less than the “price to beat” established by the Staff pursuant to the following schedule:
 - Contracts of 4 years if contract prices are less than the “price to beat” by 4% or more during each year
 - Contracts of 5 or 6 years if contract prices are less than the “price to beat” by 6% or more during each year
 - Contracts of 7 years if contract prices are less than the “price to beat” by 10% or more during each year.

- For contracts not meeting the conditions outlined above, the Staff reserves the right to challenge the prudence, reasonableness or usefulness of the contract entered.

The above described recommendations by the Staff do not constitute a finding by the Staff that any contract was prudent or that the utility's power supply portfolio was prudently structured. The Staff reserves the right to contest the reasonableness of any recommended contract on its non-price terms or the utility's portfolio in its entirety.

In the event that the independent monitor finds that the utility failed to conduct the solicitation in an equitable manner, the Commission may disallow costs incurred in conducting the solicitation and as a result of the solicitation.

Post Selection Requirements

Within 14 days of the selection of winning bids, the utility will submit to the Commission a detailed report on the process employed to conduct the solicitation and an explanation of the basis for selecting the winning bids. To the extent that confidential information is to be provided it should be noted.

The independent monitor will also file with the Commission a report on the fairness and effectiveness of the solicitation within 14 days of the selection of winning bids. In that report, the monitor will describe the process employed and will evaluate the utilities' conformity with the process requirements. If the monitor finds that the utility unfairly or erroneously conducted the solicitation, the report should so state. If the monitor believes that the selection process was flawed, the report submitted should detail the monitor's basis for such belief.

Each utility shall maintain for a period of ten (10) years, or the life of any contract entered into as a result of the solicitation plus five (5) years, whichever is longer, a complete record of all materials developed for, generated during or used in conducting the solicitation. The retained record shall include, but not be limited to, reports, internal and external communications, analyses, contracts, forecasts, bids submitted, questions received from bidders and the answers provided in response, and resource plans. These materials will be available to the Staff. To the extent that the material is not subject to a confidentiality agreement, these materials will be available to the bidders upon reasonable terms and conditions.

Sometime after the completion of each utility's initial solicitation in 2003, the Commission Staff will commence a review of the utility's power supply portfolio to examine the prudence of that utility's planning and to determine the effectiveness and efficiency of the solicitation process employed.

Sometime after the completion of the 2003 Solicitation, the Commission Staff will commence a proceeding to review the solicitation process described in this document and to make such changes to the process as may be appropriate. Any refinements will be intended to improve the process and to enhance the development of a robust wholesale energy market in Arizona. Additionally, that proceeding will address the planning for future solicitations at such time and for such amounts of capacity and energy as may be needed.